

## REVENUE DEPARTMENT[701]

## Adopted and Filed

Pursuant to the authority of Iowa Code section 421.14, the Department of Revenue hereby amends Chapter 86, “Inheritance Tax,” Iowa Administrative Code.

These amendments are necessary to implement 2015 Iowa Acts, chapter 125, which simplified the language of Iowa Code section 450.9, specified that descendants by adoption are included in the meaning of “lineal descendants” for the purposes of that section, and added lineal descendants of stepchildren to the list of people entitled to the exemption from inheritance tax. The Department hereby amends its rules relating to inheritance taxes in order to reflect those changes.

Where references in the rules mirror the prior language of Iowa Code section 450.9, the amendments reflect the new language of that section instead. References that exclude lineal descendants of stepchildren from the exemption are amended, and, where appropriate, explanations are added as to which ascendants and descendants do, and which do not, qualify for the exemption under the new language of the Iowa Code. Some examples in the rules are amended to maintain consistency with the new language of the Iowa Code.

Notice of Intended Action was published in the Iowa Administrative Bulletin as **ARC 2546C** on May 25, 2016. No public comments were received in relation to this rule making.

After the Notice was published, a Department of Revenue employee noticed an error unrelated to the legislation that these amendments were intended to implement in Schedule E in paragraph 86.2(2)“d.” Schedule E states that the tax described in that schedule is imposed on amounts over \$500. Iowa Code section 450.10(3) clearly imposes the tax described in Schedule E on the “entire amount so passing.” There is no exemption or other provision in the current Iowa Code that would explain this \$500 exemption described in Schedule E. Thus, the phrase “the rate of tax imposed in excess of \$500” is stricken from Schedule E in paragraph 86.2(2)“d” to correct this error and conform the rules to the Iowa Code. These amendments are otherwise identical to those published under Notice of Intended Action.

Any person who believes that the application of the discretionary provisions of these rules would result in hardship or injustice to that person may petition the Department for a waiver of the discretionary provisions, if any, pursuant to rule 701—7.28(17A).

The Department of Revenue adopted these amendments on June 29, 2016.

After analysis and review of this rule making, the Department finds that the amendments to these rules are not likely to have a significant impact on jobs.

These amendments are intended to implement Iowa Code section 450.9 as amended by 2015 Iowa Acts, chapter 125.

These amendments will become effective August 24, 2016.

The following amendments are adopted.

ITEM 1. Amend paragraph **86.2(1)“c”** as follows:

*c. Who is not required to file a return for ~~estate~~ estates of decedents dying on or after July 1, 2004.*

(1) Effective for estates with decedents dying on or after July 1, 2004, if an estate has no Iowa inheritance tax due and there is no obligation for the estate to file a federal estate tax return, even though real estate is involved, an Iowa inheritance tax return need not be filed if at least one of the following situations is applicable:

(1) 1. All estate assets are held solely in joint tenancy with right of survivorship between husband and wife alone; or

(2) 2. All estate assets are held solely in joint tenancy with right of survivorship, and not as tenants in common, solely between the decedent and individuals listed in Iowa Code section 450.9 as individuals that who are entirely statutorily exempt from Iowa inheritance tax on shares received from a decedent based on the individuals’ relationship to the decedent. This numbered paragraph does not apply to a jointly held interest in an asset that passes to both an individual listed in Iowa Code section 450.9 and any other individual not listed in Iowa Code section 450.9, including that individual’s spouse. See

subparagraph 86.2(1) “c”(2) for a list of individuals who are statutorily exempt from Iowa inheritance tax pursuant to Iowa Code section 450.9; or

~~(3) 3.~~ All assets are passing by beneficiary designation pursuant to a trust and are intended to pass the decedent’s property at death or through a nonprobate transfer solely to individuals listed in Iowa Code section 450.9 who are statutorily exempt from Iowa inheritance tax on shares received from a decedent based on their relationship to the decedent. ~~The entire amount of property, interest in property, and income passing solely to the surviving spouse and to parents, grandparents, great-grandparents, and other lineal ascendants, to children including legally adopted children and biological children entitled to inherit under the laws of this state, stepchildren, and grandchildren, great-grandchildren, and other lineal descendants is exempt from tax.~~ This numbered paragraph does not apply to a jointly held interest in an asset that passes to both an individual listed in Iowa Code section 450.9 and any other individual not listed in Iowa Code section 450.9, including that individual’s spouse. See subparagraph 86.2(1) “c”(2) for a list of individuals who are statutorily exempt from Iowa inheritance tax pursuant to Iowa Code section 450.9; or

~~(4) 4.~~ All estate assets are passed by will or intestate succession as set forth in Iowa Code chapter 633, division IV, and beginning with section 633.210, solely to individuals who are statutorily exempt from Iowa inheritance tax as set forth ~~above~~ below in subparagraph ~~(3)~~ 86.2(1) “c”(2); or

~~(5) 5.~~ For estates of decedents dying on or after July 1, 2007, if the total aggregate value of all the tangible personal property in the estate is \$5,000 or less and in-kind distributions are made. Any in-kind distribution of personal property is exempt from inheritance tax when the total aggregate value of the tangible personal property in the estate is \$5,000 or less. If the total aggregate amount of tangible personal property is greater than \$5,000, then the exemption for in-kind distributions of tangible personal property does not apply. See Iowa Code section 450.4(7); see also Iowa Code section 633.276 for a description of tangible personal property that qualifies.

EXAMPLE 1: The total aggregate value of the tangible personal property in the estate is \$3,000. The executor makes an in-kind distribution of a diamond ring worth \$1,000 to a neighbor. The diamond ring is not subject to inheritance tax.

EXAMPLE 2: The total aggregate value of the tangible personal property in the estate is \$15,000. The executor makes an in-kind distribution of a diamond ring worth \$1,000 to a neighbor. The diamond ring is subject to inheritance tax because the total aggregate value of tangible personal property is greater than \$5,000.

Paragraph 86.2(1) “c” does not apply to interests in an asset or assets that pass to both an individual listed in Iowa Code section 450.9 and that individual’s spouse.

(2) Individuals listed in Iowa Code section 450.9 who are statutorily exempt from Iowa inheritance tax.

1. For estates of decedents dying prior to July 1, 2016, the entire amount of property, interest in property, and income passing solely to the surviving spouse, and parents, grandparents, great-grandparents, and other lineal ascendants, children including legally adopted children and biological children entitled to inherit under the laws of this state, stepchildren, and grandchildren, great-grandchildren, and other lineal descendants are exempt from Iowa inheritance tax.

2. For estates of decedents dying on or after July 1, 2016, the entire amount of property, interest in property, and income passing solely to the surviving spouse, lineal ascendants, lineal descendants, and stepchildren and their lineal descendants are exempt from Iowa inheritance tax. “Lineal descendants” includes descendants by adoption.

ITEM 2. Amend paragraph **86.2(2)“d”** as follows:

*d. Estates of decedents dying on or after July 1, 1999.*

(1) In addition to the special rule for surviving spouses set forth in paragraph 86.2(2) “c,” of this subrule, effective for estates of decedents dying on or after July 1, 1999, an estate that consists solely of property includable in the gross estate that is held in joint tenancy with right of survivorship and that is exclusively owned by the decedent and a lineal ascendant of the decedent, lineal descendant of the decedent, a child legally adopted in compliance with the laws of this state by the decedent or

~~a stepchild of the decedent, or any other person~~ declared exempt from Iowa inheritance tax pursuant to Iowa Code section 450.9, or a combination solely consisting of such persons, is not required to file an Iowa inheritance tax return, unless such an estate has an obligation to file a federal estate tax return. ~~Property~~ For property of the estate passing by means other than by joint tenancy with right of survivorship or if any property ~~passes~~ passing by joint tenancy with right of survivorship when the title of to the property is held by persons other than a ~~lineal ascendant, lineal descendant, a child legally adopted in compliance with the laws of this state, or a stepchild of the decedent or by any other person~~ those persons declared exempt from Iowa inheritance tax pursuant to Iowa Code section 450.9, an inheritance tax return is required to be filed.

1. For estates of decedents dying prior to July 1, 2016, the entire amount of property, interest in property, and income passing solely to the surviving spouse, and parents, grandparents, great-grandparents, and other lineal ascendants, children including legally adopted children and biological children entitled to inherit under the laws of this state, stepchildren, and grandchildren, great-grandchildren, and other lineal descendants are exempt from Iowa inheritance tax pursuant to Iowa Code section 450.9.

2. For estates of decedents dying on or after July 1, 2016, the entire amount of property, interest in property, and income passing solely to the surviving spouse, lineal ascendants, lineal descendants, and stepchildren and their lineal descendants are exempt from Iowa inheritance tax pursuant to Iowa Code section 450.9. "Lineal descendants" includes descendants by adoption.

(2) The exemption granted to stepchildren and their lineal descendants is limited to ~~that class of step relationships~~ the stepchildren of the decedent and the lineal descendants of the stepchildren of the decedent exclusively. The exemption is not extended to include any lineal ascendants ~~or descendants~~ of the step relationship, such as ~~stepgrandchild, stepparent or stepgrandparent,~~ nor does it include step relations of the decedent's lineal ascendants or descendants, such as the stepchildren of the decedent's children. For a definition of "stepchild" for estates of decedents dying on or after July 1, 2003, please see the definition found in 701—86.1(450).

(3) The rate of Iowa inheritance tax imposed on a share is based upon the relationship of the beneficiary to the decedent or the type of entity that is the beneficiary. For estates of decedents dying before July 1, 2001, a net estate that is less than \$10,000 does not have an Iowa inheritance tax obligation. For estates of decedents dying on or after July 1, 2001, the net estate that is less than \$25,000 does not have an Iowa inheritance tax obligation. The following is the most current Iowa inheritance tax rate schedule for net estates over \$25,000:

SCHEDULE B			
Brother, sister (including half-brother, half-sister), son-in-law, and daughter-in-law. There is no exemption.			
If the share is:			
Not over \$12,500, the tax is 5% of the share.			
If over	But not over	Tax is	Of excess over
\$ 12,500	\$ 25,000	\$ 625 + 6%	\$ 12,500
25,000	75,000	1,375 + 7%	25,000
75,000	100,000	4,875 + 8%	75,000
100,000	150,000	6,875 + 9%	100,000
150,000	and up	11,375 + 10%	150,000
SCHEDULE C			
Uncle, aunt, niece, nephew, foster child, cousin, brother-in-law, sister-in-law, <del>stepgrandchild</del> <u>child's stepchild</u> , and all other individual persons. There is no exemption.			

<p>If the share is: Not over \$50,000, tax is 10% of the share.</p>			
If over	But not over	Tax is	Of excess over
\$ 50,000	\$100,000	\$ 5,000 + 12%	\$ 50,000
100,000	and up	11,000 + 15%	100,000
<p style="text-align: center;">SCHEDULE D</p> <p>A firm, corporation or society organized for profit, including an organization failing to qualify as a charitable, educational or religious organization:</p> <p>Effective July 1, 2001, any fraternal and social organization which does not qualify for exemption under IRC Section 170(c) or 2055:</p> <p>15% of the amount.</p>			
<p style="text-align: center;">SCHEDULE E</p> <p>Any society, institution or association incorporated or organized under the laws of any other state, territory, province or country than this state, for charitable, educational or religious purposes, or to a cemetery association, including a humane society not organized under the laws of this state, or to a resident trustee for use without this state, <del>the rate of tax imposed in excess of \$500:</del></p> <p>10% of the amount.</p>			
<p style="text-align: center;">SCHEDULE F</p> <p>An unknown heir, as distinguished from an heir who is not presently ascertainable, due to contingent events:</p> <p>5% of the amount.</p>			
<p style="text-align: center;">SCHEDULE G</p> <p>A charitable, religious, educational, or veterans organization as defined in IRC Section 170(c) or 2055.</p> <p>All other shares to income tax exempt organizations that are not defined in IRC Section 170(c) must provide their IRS letter of determination. Organizations may also be required to provide evidence that the bequest has restricted the funds to a conforming activity.</p> <p>Public libraries, public art galleries, hospitals, humane societies, municipal corporations, bequests for care of cemetery or burial lots of the decedent or the decedent's family, and bequests for religious services the total of which does not exceed \$500.</p> <p>Entirely exempt: No tax.</p>			

ITEM 3. Amend paragraph **86.5(11)“f”** as follows:  
*f. Inclusion in the estate of the surviving spouse.*

(1) Upon the death of the surviving spouse the qualified terminable interest property, which was the subject of an election, that was not disposed of prior to death, shall be included in the gross estate of the surviving spouse and be treated as if it passed in fee from the surviving spouse to those succeeding to the remainder interests. The included QTIP property will receive a stepped up basis for gain or loss as property acquired from a decedent. See 26 U.S.C. Section 1014(b)(10). The relationship of the surviving spouse to the owners of the remainder interest shall determine whether the individual exemptions provided for in Iowa Code section 450.9 apply and which tax rate in Iowa Code section 450.10 shall be applicable.

(2) Qualified property included in the estate of the surviving spouse shall be valued as if it passed from the surviving spouse in fee and shall be valued either (1) at the time of the surviving spouse's death under the provisions of Iowa Code section 450.37 and rule 701—86.9(450), or at its special use value under Iowa Code chapter 450B and rule 701—86.8(450B), if the real estate is otherwise qualified; or (2) at the alternate valuation date under the provisions of Iowa Code section 450.37(1) "b" and rule 701—86.10(450), if the property is otherwise eligible.

(3) This subrule can be illustrated by the following examples:

EXAMPLE 1. Decedent A died testate on July 2, ~~1997~~ 2017, survived by a spouse, B, aged 65, ~~and two step-grandchildren, C and D~~ a child, C, and C's stepchildren, D and E. Under A's will, all property was left in trust to pay all of the income to B for life. Upon B's death, the trust was to terminate and the principal was to be divided equally between ~~C and D and E~~, who are the ~~grandchildren~~ stepchildren of ~~surviving spouse B~~ child C. The personal representative elected to treat the trust assets as passing entirely in fee to surviving spouse B. The net corpus of the trust consists of a 160-acre farm valued at \$250,000 and personal property valued at \$200,000.

Tax on the basis of all property passing in fee to B

<u>Share</u>	<u>Tax</u>
\$450,000	\$0

EXAMPLE 2. Same facts as Example 1, with the exception that the personal representative did not make an Iowa qualified terminable interest election. In this fact situation, the trust assets are taxed on the basis of a life estate passing to the surviving spouse B with a remainder over to ~~C and D and E~~.

<u>Share</u>	<u>Tax</u>
Spouse B: Life estate factor .42226	
$\$450,000 \times .42226 = \$190,017$	-0-
<u>C's D's share ½ remainder factor .57774</u>	
$\$450,000 \times .57774 \div 2 = \$129,991.50$	\$15,498.73
<u>D's E's share—same as C's D's share \$129,991.50</u>	\$15,498.73
Total \$450,000.00	\$30,997.46

In Example 1, the qualified terminable interest election results in no inheritance tax. However, as shown in Example 2, it would have cost ~~the step-grandchildren, C and D, and E~~ \$30,997.46 if the election had not been made.

EXAMPLE 3. ~~B G~~, the surviving spouse of ~~A in Example 1 F~~, died testate, a resident of Iowa, on October 15, ~~1997~~ 2017. Under the terms of ~~B's G's~~ will, ~~B's G's~~ grandchildren, ~~C H and D I~~, inherit ~~B's G's~~ entire estate in equal shares. ~~B's G's~~ net estate consists of \$200,000 in personal property and a 160-acre Iowa farm with a value of \$250,000 both of which were the subject of a qualified terminable interest election in ~~A's F's~~ estate and in which ~~C H and D I~~ own the remainder interest. ~~B's G's~~ net estate also consisted of \$100,000 in intangible personal property ~~which B that G~~ owned in fee simple.

B's G's net estate for Iowa inheritance tax purposes consists of the following:  
 \$200,000, personal property from A's F's estate.  
 \$250,000, 160-acre farm from A's F's estate.  
 \$100,000, owned by B G in fee simple.  
 \$550,000 Total

The shares of C H and D I and their tax owed in B's G's estate are computed as follows:

<u>Share</u>	<u>Tax</u>
Beneficiary C H: ½ of the net estate, or	
\$275,000	\$0
Beneficiary D I: (same as C H) \$275,000	\$0
Totals \$550,000	\$0

[Filed 6/29/16, effective 8/24/16]

[Published 7/20/16]

EDITOR'S NOTE: For replacement pages for IAC, see IAC Supplement 7/20/16.